INDUSTRY AND COMPANY UPDATE
Lord Marshall
Chairman

There is our latest commercial running and it seems to be striking home on the right targets, as we are getting a very positive reaction to it. Good morning to you all. I suppose like the sports pundits trying to analyse the notorious unpredictability of Chelsea Football Club, you have been wondering which British Airways would be turning up today. To be honest, if we had taken much notice of the wildest speculation that has dogged us in recent weeks and months, we would be wondering that too.

In welcoming you and thanking you for being with us, let me make it clear that this is the genuine, competitive, united team you see before you. A British Airways full of commitment to our markets, deep-seated ambition to deliver profits to our shareholders and the investment needs of our business, dedication to providing fulfilling employment for our people and - emphatically - of strategic and tactical cohesion. I and all of the Board are firmly and unanimously in support of Rod Eddington and his team. The company clearly has its problems right now. However, dissent at the top in any shape or form is not among them, nor has it been. Rod is the right man in the right place for what has to be done. These are by no means the first difficult times the airline has encountered but they are probably the worst, save possibly for the exceptional losses and heavy cutbacks of the early 1980s before the airline was prepared for its successful privatisation.

With widespread economic slowdown, the pernicious effects on UK travel and tourism of foot and mouth disease and a high exchange rate, the situation was already difficult. Then, of course, came 11 September. Some have described the situation as a cocktail of catastrophe and I would not, on the whole, disagree. The effects on the industry at large and many individual airlines, principally the major intercontinental operators, have been dire. For some, they have been disastrous. You know the toll of minus numbers as well as I do and just last week IATA reconfirmed its early prediction of a collective £7 billion industry loss for 2001. The downturn in business travel demand, notably across the North Atlantic, and increased "no frills" competition for short-haul business in the British markets had their effects. Our January traffic statistic showed that demand continues to improve from the low point in October.

Although necessary marketing initiatives, all those special offers, have diluted revenue from the strength we would normally expect, the overriding priority has been to get people moving again. The improvement in seat factor is a direct result of the decisive action taken on capacity. We have, as you know, been focused on meeting changing competitive and economic environments for some time, and costs have been progressively reduced. Significantly, substantial investment has been made in product and service innovation both in the air and on the ground. It was obvious to us that this current financial year was going to be tough even before the September tragedies and their repercussions.

That is why, in the immediate aftermath, we decided to go much deeper with a comprehensive root and branch review of our business and the challenges we face in the future. I am pleased to say that this review, the Future Size and Shape study, has now been completed and the decisions taken. It is not, of course, totally conclusive, because change is an ongoing process but it defines, or rather redefines, the kind of business British Airways needs to - and will - become. The work has involved stripping away the existing fabric of the airline and getting right back to the starting point of any business, the consumer.....the customer. The focus has been on providing customers with the service they want at a price that is acceptable to them and at costs which make an acceptable profit for shareholders. It means that, in some cases, our existing way of doing things will have to be changed radically. It includes changes to the number of people we employ, the way in which we work, the way we sell and distribute our wares and to the route network itself; and costs in each of these areas must come down.

Notwithstanding what I have just said, we will continue to build our premium business on a value-for-money basis. The review has also concentrated on building on established strengths, most especially our strong customer service ethos, commitment to quality and operational integrity, and none of these will be allowed to suffer through economic cutback. We see them rather as economic benefits.

As we look out across the year ahead, we see signs of the beginning of improvement with more encouraging economic forecasts in the United States, the air travel market, notably the business travel sector, will recover over time. As it does, we can be confident that our product and service innovations will set us well ahead of competitors who may find it difficult in new economic circumstances to match our level of investment and to catch up with British Airways.

The Future Size and Shape review has competitive issues high on its agenda and speakers this morning will flesh out the details. You should know that the Board has engaged several times in reviewing the output and recommendations of Rod and his team, and I want to re-emphasise that what you are about to hear has the full support of every single member of the Board, and this will ensure the best possible outcome. We have no doubt that the British Airways team can deliver reform and revival in the most effective way to the benefit of customers and shareholders alike, as well as for our most important asset, our people.

Now to give you the detail of what you have been waiting for, here is Rod Eddington.

FSAS INTRODUCTION
Rod Eddington
Chief Executive

Good morning everyone and I am delighted with the support of the Board through this important process. As the Chairman said, we met several times with the Board over the months as the Future Size and Shape work unfolded, and it was an extremely important part of the process.

We all know that many of the challenges we face were not caused by 11 September; we were already facing major challenges before that date. The Future Size and Shape team looked at the whole range of our operations - as the Chairman said, root and branch of our business – to ensure that we address all these important underlying challenges.

Let me turn to the major focus of this morning's presentation. We must return our business to profitability as soon as possible. We have, as our business has grown and expanded, added a lot of complexity to what we do at British Airways. Complexity adds cost, cost undermines profitability. We need to recognise that the "no frills" players are genuine players in the all important short-haul market. We can no longer rely on our long-haul business to subsidise our loss-making short-haul business. We face competition on two fronts: from the "no frills" carriers and from the rejuvenated full service carriers such as Lufthansa and Air France.

One of the things that we have done as part of Future Size and Shape is take some important learnings from the "no frills" players: the importance of single aircraft type on short-haul; in fact, the importance of reducing the number of aircraft types in the fleet as a whole; the importance of increasing utilisation; the importance of simple pricing and of using the Web to reduce distribution costs. We recognise, too, that if we are going to get our business back into sensible profit territory, we need to make sure that it supports the right number of people. We must recognise that manpower costs are our major cost and we have to ensure that we have got the headcount right. We must make British Airways a more robust business. We will deliver but more on that later.

Let us look at some of the broad financial targets and, as George said, John Rishton will be talking in much more detail about some of this a little later. We are targeting an operating margin of 10%, something that other successful businesses and, importantly, other successful airlines, have delivered. We are confident that the steps we are announcing today will help us reach that target. We will then be much better placed to withstand the peaks and troughs that inevitably come our way as markets ebb and flow. We will reduce our annual costs by around £650 million over the next two years with £450 million, i.e. the lion's share of that, being secured in the first year.

We have made some sensible and modest assumptions about revenue growth. There will be some growth, we believe, but it will be modest. To deliver a 10% operating target, we must be very clear about making the changes to our cost base. As I have said, our predictions on revenue growth are modest.

A key part of Future Size and Shape is building a much simpler BA. That is true across the business, whether we are talking about systems, whether we are talking about fleet, whether we are talking about how we sell, price and distribute our products – all of those issues will be touched on this morning.

We will restructure our short-haul business to compete with the "no frills" carriers. There are some important pieces on that to follow, in particular the piece that Andrew Crawley will be talking about on how we position and sell on the short-haul network. Before that, Robert Boyle will be talking about the network piece of it.

We must recognise that we need far simpler pricing structures to give business travellers and holidaymakers alike greater flexibility, more choice, lower fares. British Airways lowest fares will be available online.

We have taken something like 40% of capacity out of our Gatwick operation since 1999. We intend to reduce our capacity at Gatwick still further by an additional 20% over the next two years. A further eight routes will be transferred up the M25 from Gatwick to Heathrow. We currently operate at Gatwick Boeing 747s, 777s, 767s, ATRs, regional jets and 737s. By 2003 we will have just two aircraft types at Gatwick: Boeing 737s on the short-haul route network and Boeing 777s for long-haul routes. A simpler short-haul fleet at Gatwick will mean higher aircraft utilisation.

Manpower: we will be reducing manpower by a further 5,800 on top of the 7,200 we announced in September 2001. In total, this amounts to a manpower reduction of 13,000 or 23% on the number that we had in August 2001, i.e. immediately pre-11 September. The number of people we had MPEs in BA at that time was 56,700, so we will be reducing that number by 13,000. We aim to achieve this by voluntary means and we will work with the trades unions to achieve the target. Total head office and support manpower will be reduced by more than one third, we must reduce our overheads.

Let me point to the key things that we have done over the last 12 months, because the critical thing about Future Size and Shape will be delivery, and we are confident that we can deliver the things we are talking about today. We have already delivered significant change and improvement to our business at Gatwick. Our short-haul losses have reduced from £310 million in 1999/2000 to £172 million in 2000/01. We reduced from the three months through to the end of 31 December our total costs at British Airways by 8.5%. We announced a manpower reduction target on 20 September of 7,200 to the end of this current financial year. We had by the end of December delivered 5,800 of those and we were well ahead of schedule.

So Future Size and Shape, the end result. Post Future Size and Shape versus August 2001, we will have 9% less capacity in the business, 10% higher short-haul utilisation, 15% fewer destinations, 49 fewer aircraft, and we will come to the detail of that later, 40% fewer sub-types, and Robert Boyle will be speaking to that in a minute, 52% less capacity at Gatwick and a total manpower reduction of 13,000.

Let me just remind you of the key areas that we are going to tackle. Profitability: we must restore the company to sensible levels of profitability. We must simplify our business, remove complexity and the costs that go with it. We will find a way of sensibly competing with the "no frills" carriers, which allows us to be profitable on the short-haul. We have to make the right decisions on headcount, and we will deliver the things we are talking to you about today.

I shall now hand over to a couple of members of the Future Size and Shape team: Robert Boyle, who is also head of network development, and Andrew Crawley, who is our AGM for Europe both worked as part of the Group of Five on Future Size and Shape, and they will flesh out some critical details for you about this programme. You will then hear from our CFO John Rishton. If you will excuse me, I would like to leave you now. Today, as you will appreciate, is an extremely busy one and I am now going to talk to different groups of staff inside our airline. I am sure you will have plenty of questions and I shall be back later on to help answer them as part of the Q&A session at the end before joining you all for a well-earned lunch. I shall now hand over to Robert Boyle.

FSAS Part 1

Robert Boyle
General Manager Network Development

Presentation with slides

Good morning everybody. I will be taking you through the detail of the proposals that we are announcing today, and I would like to start where the five of us started - with an overview of the external environment against which we should plan our business.

Starting with demand: the outlook for our markets is inevitably a combination of effects, firstly the economic cycle; secondly the speed and degree of the recovery in air travel demand from the huge drops in traffic which followed the events of 11 September; and thirdly, and perhaps as important as the others, the underlying market trends which were already with us in terms of changes in the competitive environment. I will not dwell on the outlook for the global economic environment, since I am sure that everyone here in this room will have their own views on the subject. All I will say is that it is clearly a highly challenging economic environment for an airline such as ourselves to deal with. We are expecting some gradual recovery starting in earnest in the second half of 2002, albeit that clearly is from a very weak base.

In terms of air traffic, it is a game of two halves. The leisure markets are already recovering and we have in some instances positive volumes versus last year in leisure markets. Clearly that has been achieved in part at the expense of yield, with the whole industry discounting heavily to stimulate demand. Business markets will be slower to recover. They are off the depths that they hit in the immediate aftermath of 11 September but it will take some time for those markets to recover, with premium travel in particular remaining depressed for a while, with changes in corporate travel policies not necessarily being reversed quickly - or indeed ever. Finally on yield, it goes without saying that this remains under pressure, although our existing fleet, product and network strategy has and will continue to provide at least a partial offset.

On the subject of competition, we will have much more to say later in this presentation on the subject of the "no frills" carriers, but it should not be forgotten that we face ever-stronger competition also from the global network alliances and the full service carriers that make them up, with Star and Skyteam of particular note. Any proposals we came up with in the review would need to deal with both classes of competitors.

Deregulation is an ongoing theme in the airline industry. The single biggest event which could have hit us in the short term, UK/US Open Skies, given recent events, is now not in imminent prospect.

On consolidation, we have said a number of times that consolidation in Europe is needed - there are too many airlines chasing too few passengers. We have also made it clear that consolidation can and will take a number of forms. Bankruptcies of weak carriers are the cheapest form of consolidation for the stronger carriers that remain. One of the other lessons from the US industry is that consolidation can also take place through asset acquisitions, rather than purely through mergers and acquisitions of total airline entities, so gates and slots were amongst some of the best consolidation deals that were done when the industry hit difficulties. Clearly that is something which we will ourselves be pursuing; difficult times do present some opportunities in these areas.

Finally merger opportunities: clearly this is part of the consolidation scene. The events in Belgium and Switzerland demonstrate that the barriers to real, genuine consolidation of flag-carriers in Europe remain high, not only in legal and regulatory terms but also in political and employee terms.

Last but by no means least, despite Rod's instructions to the five of us that we should start with a blank sheet of paper, in reality we needed to generate a solution which reflects the constraints that we face. A backdrop of large financial losses in the current year and a heavy debt burden to service was always going to dictate, at least in part, the range of options that we could realistically consider, and we have conducted our review against that backdrop.

Rod has touched on the key issues that the review needs to address: the profitability of our business, not only in total group terms but also addressing the imbalances in the business, in particular reliance on profits from the North Atlantic and the losses in the short haul business. We also felt strongly that a large part of the solution had to come from simplification across the business, eliminating unnecessary complexity and its associated costs. Finally, no solution which did not adequately address the competitive challenge of the "no frills" carriers was, we felt, not a complete solution.

As befits a review with the title Size and Shape, we early on identified and evaluated a range of radical further changes to capacity in the business, many of which have been the subject of some press speculation. We looked at the closure of our entire Gatwick operations; we looked at a retreat to long haul - the so-called “BOAC option”; we looked at further significant downsizing of the business and associated ‘slashing of the route network’, as the press would describe it, over and beyond the 20 per cent reduction in capacity which we had already set in train. Finally, given the shift in the market with considerable down-trading from premium, particularly in the short haul business, we looked at whether the time was right to move away from a two-class operation in our short haul business - or at least for a portion of it such as Gatwick. Each of these four options were evaluated in some detail but were rejected.

Why did we reject them? There are three principal criteria on which we judged whether any of these, or indeed other options, should be taken forward. First and most obviously, financial impact - not just whether the changes would contribute to meeting our 10 per cent operating margin target, but also what impact they would have on the imperative to reduce debt. Critically important also was deliverability. It would have been pointless to come here today and give you a plan which we did not feel was deliverable in practice. Thirdly, a solution in our view had to leave the business stronger competitively at the end of the process rather than weaker. The four options which I referred to on the previous slide all failed against these criteria, and in fact failed on more than one criterion.

What this exercise also demonstrated, perhaps unsurprisingly, was that there was no simple silver bullet - just closing Gatwick, just addressing short haul - none of these things would solve the problems of our business and nothing less than a restructuring which touched every part of our business would deliver our objectives.

We will now get into the meat of what we are going to do, starting with the fleet and network piece. In terms of fleet and network strategy, we are not fundamentally changing the strategy we have been implementing over the last two or three years. For those of you who have not been to the last two of these Investor Days, I will summarise this in a fairly straightforward fashion as a shift towards smaller aircraft, both to improve revenue mix and to support frequency development to key business destinations. The long haul aircraft changes as part of the strategy are now complete; we took our last 777 delivery in October and the 747-200 aircraft left the fleet at the same time.

The short haul changes were always going to come more slowly, since we had to change many more aircraft in the fleet as we retired a significant proportion of our 767 and 757 short haul equipment and a large number of our 737s, replacing them with a mixture of A319s and A320s. Those changes have begun to bite with significant effect this winter season, and you can see the impact that this has had in part on our seat factors. That process will not be totally complete next summer but will largely be there during the next summer season, so the fleet changes we set in train in the last two to three years have either now delivered or will arrive very shortly.

Just over a year ago we announced a shift in strategy for Gatwick, with a 40 per cent reduction in capacity and a move away from trying to run Gatwick as a second hub airport in the south east of England. We announced that we were repositioning Gatwick as a point-to-point airport for short haul routes, and some long haul destinations which did not fit into Heathrow and could be profitably operated from Gatwick, a good example being the Caribbean operation. That strategy remains unchanged. We are announcing here today that we have accelerated and are taking it further in terms of total capacity reduction.

In headline ASK terms, where we will be post future size and shape, is 21 per cent smaller than we were at our peak. As I mentioned earlier, about a year ago we announced with the Gatwick changes that our total capacity would reduce to 20 per cent below '99 peak levels, so post future size and shape the total capacity reduction in the business in headline ASK terms will not be materially different from that which we had already set in train. Clearly the make-up of that capacity reduction will be different in detail. We are reducing Gatwick more than previously expected, and a greater proportion of the reduction will come from destination cancellations and reduction in the flying programme.

When we set in train those plans we were clearly planning for a rather richer business market than now will be the case, so there are some small revisions to the amount of premium capacity within the total, and that in part explains why the headline capacity figure is not reduced further from that which we have previously announced.

So what are we changing on the fleet and network side? We are announcing some further trimming of London routes, and I will say more about this and other items in the slides which follow. We are as I have said announcing a greater and faster downsizing of Gatwick. We have changes in fleet deployment which will simplify our regional operations and other bases in the business, with a major push on trying to cut the number of sub-types that we operate, and we will have a drive on pushing up short haul aircraft utilisation.

Coming first to the specifics of the network changes, since 11 September we have announced - and largely already implemented - 14 route suspensions. They consisted of around eight short haul route suspensions at Gatwick, pulling out of Belfast from Heathrow, coming out of Manila and Taipei in Asia, pulling out of the New York market from Gatwick, and a couple of other minor changes. We are announcing here today that we expect to make another 10 suspensions over the next 12 months. We are not announcing the details of those today, except to say that we would expect them to be evenly split between long haul and short haul routes, and to take effect from the start of the winter season.

There are a number of reasons why we are not announcing the specifics of these routes today. Clearly there is a high level of commercial confidentiality in announcing a route suspension some way in advance of when you plan to implement it, but more importantly we have a number of consultations to conclude, both with our staff where we have legal obligations, but also with airports and other suppliers where we believe that the final decisions should not be taken until we have had an opportunity for them to make us an offer which might persuade us not to terminate such a destination.

What we are announcing today is a further set of route moves from Gatwick to Heathrow which will take effect from the start of the summer season, four Eastern European routes - Riga, Kiev, Ottopeni and Zagreb will move from Gatwick to Heathrow - and four long haul destinations will move additionally at the start of the summer season - our two Nigerian points, Lagos and Abuja, and services to Mauritius and Buenos Aires will move to Heathrow. In part these route moves relate to the fleet changes that we are making; with the exit of 747s from Gatwick some of those routes will be served better by retaining a 747 from Heathrow.

I will talk a little more about Gatwick. What is the role of Gatwick in our business? Our proposals build on the already-planned reduction and de-hubbing of Gatwick, and essentially do not reflect a change in strategy. Gatwick is there to strengthen the London network. Whilst the number of destinations we serve from there will go down considerably, it still represents quite a large component of the breadth of destinations we serve from the south east of England, and it is important to strengthen our proposition to our core customer group in the south east of England.

We also believe that there are quite a number of services which are and can be profitable which simply do not fit at Heathrow, and our work on looking at a complete closure demonstrated that the financial disbenefits of losing such destinations was not sensible. Clearly we believe that Gatwick needs to, and can, earn an acceptable return to the business and our plans, including the ones which Drew will take you through on the commercial and selling side, will ensure that we can make Gatwick a profitable business.

These are the headline figures in terms of numbers of aircraft and destinations that we see for our Gatwick operations. Long haul fleet count drops from a peak of 33 aircraft down to 11 aircraft by the middle of summer ’03. A large proportion of that reduction has already taken place or will take place at the start of the summer ’02 season, with the fleet down to 16 aircraft from April. All of those 11 aircraft will be 777s; the 767s that were there in summer ’01 have already moved to Heathrow and the last of the 747s will move during the summer season.

On short haul, the total fleet count for our Gatwick-based shorthaul operations EOG (European Operations Gatwick) and Cityflyer, which we are in the process of merging, will drop from a peak of 57 aeroplanes back in August to 35 aeroplanes by the middle of summer ’03. Those 35 aeroplanes include five turboprop aircraft, ATRs, whose leases will expire later in 2003 and which we do not intend to replace; so that by the end of 2003 the Gatwick short haul business we would expect to have 30 aeroplanes, all 737s. We are moving the RJ-100 aircraft - of which we have 16 down at Gatwick - to the regions in order to achieve this fleet simplification, and I will come back to talk more about that in a second.

In terms of destinations, Gatwick has been on a fairly long and steady march downwards in terms of the breadth of destinations we serve from there, dropping from a peak of over 100 destinations in total down to just under 50 by the time Size and Shape is completely implemented. About half of the destination loss is destination loss to the BA network; the other half is either routes which are moving from Gatwick to Heathrow or is the elimination of duplicated routes which we served from both Heathrow and Gatwick. In headline ASK terms by ’03 we will be 60 per cent smaller than the peak at Gatwick, with 46 per cent reduction by April.

Turning now to the regional activities outside of London, we have made a number of announcements over the last months around consolidating our short haul businesses outside London into a new entity which we have called British Airways CitiExpress. This merges the operations of Brymon Airways, British Regional Airlines and British Airways Regional, and I for one will be very pleased not to have remember all those acronyms.

This will be the largest regional airline in Europe; even before the transformation of Crossair into the latest trans-continental European airline it would still have been the largest regional airline in Europe. I have mentioned already that we plan to replace the Airbus and 737 fleets currently based at Manchester and Birmingham with RJ-100 aircraft from Gatwick. CitiExpress already operates 146s and this moving of the RJ-100s, which are a common cockpit type, to the regions enables CitiExpress to achieve a significant reduction in fleet complexity, and will complete the transformation of our operations outside London into a separately-run operation, with cost structure and aircraft type suited for the market conditions.

Together with some associated network rationalisation which has been ongoing in the regions, capacity outside London will fall from the level we had this year to next year by around 5 per cent. City Express is also announcing a couple of changes which affect particularly the Isle of Man today, and David Evans our General Manager of that business is briefing the Isle of Man government as we speak. We are announcing two things: one is that we will no longer fly a separate brand from the Isle of Man - Manx Airlines will cease to exist as a separate brand, which will go some way to simplifying the operations in the regions - and we are also announcing that Isle of Man services which currently fly to Heathrow will move to Gatwick.

I want to talk now about fleet simplification. I will start with our Heathrow long haul business. I have listed in the first slide the nine aircraft type and seating configuration permutations that we had in operation in summer '01. In terms of different aircraft types we had 747-400s, 747-200s, 777s and 777s extended range. We did not at the time have a 767 fleet at Heathrow but we do now. However, the true fleet complexity was greater than that apparent simplicity implies. We flew with no less than four different seating configurations on the 747-400; we had a 102 Club seat variant which was introduced in the immediate aftermath of the Concorde disaster as a very quick response to put some extra premium capacity into the New York market. For a variety of reasons, not least the resumption of Concorde services to New York and the drop in business demand, that fleet configuration has now been eliminated. We had two variants of the 747-400 with the new flat bed product on board, a high premium aircraft with 70 Club seats and a low premium aircraft with 38 premium seats. Both of those two will remain, and we believe will provide good coverage of the range of destinations that we serve from Heathrow.

We also during this period had clearly a number of aeroplanes which have not been embodied, and given the very large differences in total seat count between unembodied aircraft and newly embodied aircraft, it was critical for us to plan these fleets separately - which has been quite a complexity in the business and has caused significant aircraft utilisation drops. During the transition we hung on to 747-200s to enable us to execute that transition, but as we move into next year and on into 2003 the completion of that embodiment programme gives us a very substantial reduction in fleet complexity, and together with the exit of 747-200s and a convergence of our 777 configurations on to a seating configuration which is much more common across all of the 777 types gives us another reduction in fleet complexity. The 767s have moved from Gatwick, as I have said, which adds to Heathrow complexity but reduces it at Gatwick.

If you then look across all the other bases and long haul/short haul types, Heathrow long haul reduces from nine to five as we have seen, a 44 per cent reduction. Gatwick long haul goes from six variants down to three; the three are all 777s but will have some variations in on-board seating configuration. The lack of an Open Skies deal which would permit the movement of high premium-demanding routes, such as Houston to Heathrow, does limit us in the amount of simplification that we can execute in the Gatwick long haul business; we would have planned for a rather greater reduction with a different assumption.

Heathrow short haul drops from five types - 767, 757, 737, A320 and A319 - down to four with the elimination of the 737 fleet type from towards the end of 2003. The move of Airbuses from Birmingham is one of the ways in which we accelerate that simplification of the Heathrow fleet. Our push on aircraft utilisation, as we will say further, also helps us to get faster to the end game of fewer types. Importantly on Heathrow short haul we reduce from three to two flight crew cockpit types. The 757s and 767s are common-crewed, as are the A319s and A320s. Elimination of the 737 fleet from Heathrow will therefore help considerably in improving pilot productivity.

In Gatwick short haul we move from a position of flying two variants of 737s, an RJ-100 and the ATRs down to two, both of them being variants of the 737s - so the same family. In the UK regions we drop from nine to six with the elimination of the Airbus and 737 operation, and termination of some odd-ball aeroplanes which were still in the fleet at summer ’01. Overall as a simple metric of the fleet simplification moves we are taking we reduce from a total of 33 base / haul / seating configuration permutations down to 20 by around 2003.

Aircraft utilisation: we will deliver a 10 per cent improvement in short haul aircraft utilisation. How will we do that? The first item is that there is a natural benefit that we are getting and will be getting through the changes that we are making on the fleet side. Newer aeroplanes are more reliable, need less engineering downtime, and can achieve higher levels of operational regularity without the level of buffer and standby cover that we currently plan to protect punctuality. Our move to simpler fleets is clearly a benefit to aircraft utilisation, and finally smaller aircraft in and of themselves will turn around faster; we turn a 319 around faster today than we turn a 767 around, for obvious reasons.

We will also be targeting turnaround times in themselves, so for a 319 aeroplane which today would plan a minimum turnaround of 45 minutes. We will in future take five minutes off all of those aircraft turns, and 10 minutes off where it is a domestic-to-domestic turn where we do not have to change the seating configuration (we do not need to “move the curtain” because it is a single class operation in domestics).

More off-peak flights: one of the principal differences which lies behind the difference in aircraft utilisation between the “no frills” operators and our own operation is the degree to which they fly early in the morning, late at night, and at other off-peak times. We believe the changes we are making on the pricing and distribution front and in terms of operating cost reduction will make such flights more viable than previously they have been, and will contribute to our ability to achieve an aircraft utilisation improvement.

Headline statistics on the total network in terms of numbers of aeroplanes: long haul comes down by 14 aeroplanes from where we stood in August by ’03; retirement of the classics is part of this, but we also have two 777s which we are in the process of selling. I cannot unfortunately share with you the details of where they are going but they will go from next Spring. We are announcing today that we are also planning to market a further five long haul aeroplanes; clearly the precise mix of those will be determined by conditions in the aircraft market. A big driver behind that decision is clearly to get our debt down, so we will be looking to sell aeroplanes that generate cash for the business and reduce debt.

On the short haul side total aeroplanes drop by 35 from where we stood in September by ’03, and that is achieved by a combination of network rationalisation and the push on aircraft utilisation. It will be executed by taking advantage of lease return opportunities which we have over the next two years, in particular in our 737 fleet which is financed quite flexibly.

In terms of destination count, we reduce on the long haul side by 11 destinations and on the short haul side by 12. The route suspension number is slightly larger than this because, as I have said, we are eliminating duplication of routes from Heathrow and Gatwick in some instances. We are at the moment planning only a small reduction in destinations served from the UK regions, but David Evans is also announcing today that he is conducting a second round of reviews of the UK regional business now that the corporate position is clear, and he has clarity on the fleet assumptions that he should make.

In terms of total capacity that comes out, we have mentioned the 21 per cent number already and that is the number for summer ’03 versus the peak in 1999; but we will hit that figure in the next summer season which starts in April.

To summarise: our basic fleet and network strategy remains unchanged. We have accelerated it, both in the immediate aftermath of 11 September and through the changes we are announcing today. It does reflect a big reduction in capacity from where we stood, in particular at Gatwick, but the real difference that we are pursuing as a result of these changes today is a major drive on fleet simplification and aircraft utilisation. Our short haul business will be smaller than it has been and is today, but at some 200 aeroplanes it remains a significant business, and addressing the profitability of that business is clearly a critical item for us in the overall financial performance of BA.

I will hand over now to Drew to take you through more details on that point.

FSAS PART II
Andrew Crawley
General Manager Western Europe

[*Presentation with slides*]

I am the General Manager for Western Europe and not Europe, as Rod Eddington stated earlier. That is not unless I have missed something in more recent times!

I expect by now you will have worked out that we are not going to do what you may have read in the press over recent weeks. For those of you who may have arrived late and missed Rod Eddington's speech and, indeed, Robert Boyle's speech, all of these headlines that you may have seen in the press over the past few weeks is what we are not going to do. So I am here today to explain what we are going to do and that is to turn round our short-haul business to make it profitable by competing effectively with the low-cost carriers, intelligently and profitably. We will do that by keeping the bits of British Airways that work well in this new short-haul business model and taking some learnings from the "no frills" competition.

To do that, let us take a quick look at the competitive environment we are working in. Many of you will have seen advertisements such as this one, which have been around for about three years. The style is consistent with most of the "no frills" carriers: it is a very straightforward, low price proposition, a low lead-in price which takes you directly to their website where you will make your booking. This ubiquitous orange you will be most familiar with, because it is in tabloids and broadsheets without discrimination and, overall, the "no frills" carriers spend around £16 million a year on advertising, so that is why you are probably more familiar with it. They always use this lead-in price to capture the imagination of the customer who will then go into the website.

Upon entering the website, you will find this fare along with many others and behind it exists what we call a fares ladder. So there are a number of fares that are pre-set against which the "no frills" carriers allocate certain amounts of inventory. Broadly speaking, the lower fare inventory is closed off the nearer you get towards the departure date of that flight. So this has been affecting our leisure market over the last few years but, more recently, what we have seen are advertisements and leaflets of this nature: "Business travel has changed – have you?"

This specific example is an easyJet advertisement, which pours out some of the more compelling propositions to the business traveller such as frequency, good punctuality and also has a firm positioning on value. So this is a direct attack on our Business Traveller proposition in Europe.

This slide shows you some statistics. The “no frills” carriers compete with British Airways on 62% of our short-haul network from London. The capacity figure is greater than that, because the routes where they do not compete are the smaller routes that we operate out of London. They have had an explosive growth over the last three years of over 300%, to give them the sorts of frequencies - 5,500 in February compared to 8,000 in February for us. So they are a sizeable competitive challenge for us.

Every time the “no frills” carriers introduce themselves to a new market, the market grows but, in addition, we lose leisure share. The last point is an interesting statistic which we need to be aware of, because that gives us a flavour of how the market is changing structurally. That is that the classic segmentation we have used in the past of using business travel agents to determine business travel and leisure travel agents for leisure travellers is being broken down. Business travellers are asking for value for money, evidenced by the fact that 27% of British Airways low fares are now bought through business travel agents. Some of that will be for leisure purposes of the business travellers, because they go on holiday too, but much of it is business travellers using inflexible fares that we sell and buying two tickets instead of one and throwing away coupons. So the market is changing and our response has to address all those issues.

What is our response? We will strengthen and maintain our offering to the business market. It is a critical market for us. Club Europe and full fare economy passengers are highly profitable for British Airways, so we will strengthen and maintain our positioning on that. We will move short-haul economy closer to the “no frills” model by keeping what we think is good about what we currently offer and using some learnings from what they have on offer too at the moment. Finally, cost efficiency improvements across the whole business - and some of the numbers that Rod showed this morning demonstrate some of the initiatives that will improve our unit cost across the whole business - but specifically on the short-haul piece will bring our unit cost down to enable us to compete profitably.

What does the proposition look like for the business traveller? We will maintain and build on a strong Club Europe offering. Forty percent of our revenues in short-haul out of

Heathrow are Club Europe, and the same number for Gatwick is 30%. I have said before that it is highly profitable. The market was flat before 11 September, it came down quite significantly but is recovering slowly now. Importantly, we have been growing our share in this very profitable market.

Convenient airport locations are critical for business travellers in Europe. Flying from Heathrow and Gatwick we offer convenient airports, and we have schedules and frequencies that match the needs of the business traveller. Out-and-backs in a day: we will improve on that at both ends of the route where we have key cities in Europe.

Research has shown us that the number one priority for business travellers in Europe is speed and efficiency throughout the journey. Where we have the ability to influence speed and efficiency we will do so. We have automated products such as e-ticket, self-service kiosks, online check-in, and we will package all of that to make the whole process smoother for our business travellers. In some airports, where we are able to do so, we will change infrastructure to remove some of the bottlenecks that you would be experiencing especially of late with the additional security arrangements.

Frequent Flyer programme we are reviewing to ensure that we are competitive in Europe at the right price for us and also engender more loyalty from our frequent passengers. Customer service and operational reliability: that reinforces partly the speed and efficiency aspect of the business traveller proposition. We are operationally very sound, we have a good track record. We are a big airline and people rely on us to sort problems out when they arise. So if an aircraft breaks down travelling with British Airways, people feel comfortable that there is a back-up aircraft available. Our research has shown that that is a very big plus point for us. Finally, changes to the way we price and distribute. There is a distribution slide a little later on but the pricing piece is about offering more choice and control to customers, allowing them to make the trade-off decision between price and flexibility.

Adapting our short-haul economy product proposition. Pricing is a key element of this. We will be introducing a new pricing structure. While I am on the topic of the pricing structure, we are introducing most of these changes progressively between now and June, and June is the critical date because that is when we are making our distribution changes. We are announcing them today but June is when they start. We have a legal obligation to give notice to travel agents that we will be changing their contract and that starts today and will be implemented in June. This means that the whole package will come together in June but you will see some of these things entering the market in between times. So we will be putting a new pricing structure into the market, which has lower lead-in fares for customers, greater choice and flexibility and puts the onus and responsibility to the customers to get them to make the trade-off between flexibility and price. To do that we need to change the way we inventory manage, and I shall come on to that in a minute when I have a slide that looks at the way we do it currently and the sort of model we will be moving to.

Communication is critical. We have seen advertisements from the “no frills” carriers. The way we advertise our low fares currently is in waves of what we call world offers, which are our low fare offering to the marketplace. The prices are competitive but, for the consumer to find these prices, our inventory management logic has to change so that it is a more compelling proposition and easier for them to find.

Finally, online booking. Many of the distribution changes that we will be making put a greater onus on us taking some of our business through our online channel. To do that effectively, we have to make improvements to our current booking engine, and I will take you through what they are. We are doing them now, there is a live test site on our website of our new booking engine, and I shall be able to take you through some element of that in a minute.

Distribution costs I shall be talking about in more detail. They are a big cost on short-haul. We have addressed distribution costs in the UK twice in the last four years, and we are announcing more changes, details of which I shall give you in a minute.

Finally, delivery costs of the product in all aspects. Some of the headcount numbers to which Rod alluded earlier will be delivered through productivity initiatives and pulling out of overhead. Clearly, that will reduce the unit cost specifically on short-haul as well as across the rest of our business.

Part of this is about changing the price perception people have of British Airways. We have done a fair amount of research and people think we are expensive and there are reasons for that which I shall come on to. However, on Friday last week we did a spot check on London-Amsterdam and on London-Barcelona. We are not saying we will always be price competitive but the next two examples of us out of Heathrow relative to a “no frills” carrier can give you the flavour that we are not that far off beam when compared with the prices that we can deliver to the customer. We do not always do it consistently, so there is room for improvement there, but we can be competitive.

This slide shows London-Amsterdam and down at the bottom is the detail of what the booking is all about. It was quoted last Friday for an outbound trip on 14th, returning on 18th. You will notice two things: first, that we are cheaper and, importantly, our web price of £103 is more expensive than the lead price even published as the return price of the "no frills" carrier. That lead price will have been published on the website at around half that level, so about £46 would have been the price that grabbed the customers' attention, whereas our is £103. Price including other charges: on top of the "no frills" lead price turned into a return trip you add other charges such as taxes, security charges and so forth. For us, rather perversely and we are changing this, you get a discount for booking online using an e-ticket. The reason why we do it this way is because of the current nature of the distribution system that we operate in. That will change as part of the distribution changes that we will be making, so we will be able to advertise the £98 in future.

The next example shows London-Barcelona. Again, the final price paid for the consumer: we are very price competitive. You could say that we have left money on the table in this instance but, again, the "no frills" would not have advertised at £205; that would have been advertised at the one-way fare, again, turning it into a return, whereas we are leading in on a price of £169.

How will we change our inventory management to facilitate lower lead-in prices and simpler proposition to the consumer? The left-hand side of this slide shows how we currently manage inventory. It is demand driven and, because demand changes quite radically over time, so do our prices that are available. Therefore, as soon as we get more demand, the price goes up and the availability of the lower fares is cut off and, when that demand falls away, we open up our low fares again. So it is driven by the demand for the high yielding end in fact rather than anything else.

How that manifests itself if you are a consumer going onto our website on day X, which might be on the left-hand side, is that you might see a £100 fare to Paris, for example. If you did not book it that day but went in a couple of days later, it would no longer be available and it may be replaced by a £300 fare, only three or four days later to be replaced by a £100 fare. So you can see that, in terms of consumer proposition, it is not that easy for them to understand when or why we have low fares available.

On the right-hand side, it is easier as that is the fares ladder that I was describing earlier that the "no frills" carriers use. That is dynamic as well. It does not look very dynamic as it is but what that will allow us to do is take a low lead-in fare, have our own fares ladder, have sensible trade-up steps for people to make their own choice and trade-offs against price and flexibility, and we will move the availability of those particular steps according to demand. The proposition to the customer becomes the earlier you book, the more choice you have. So that is what we will be moving to.

Having moved to that inventory management model, we need to ensure that our customers can find these fares when they come onto our website. Our current booking engine for good reasons – all the historical stuff is for good reasons but they never seem quite such good reasons on the day – searches by day and flight. So you select the destination to which you would like to fly, you select the date and our booking engine search comes back with a price. Sometimes that price might be very reasonable, sometimes it might appear expensive. That reinforces our price perception in the marketplace currently, because every time you go in and look for a price that you may have seen advertised, it is not that easy to find and you may end up with a much higher price. So it is critical that we get that part of the delivery of our price proposition to the customer right, so that we change the price perception, because we do have low fares in the market. We have plenty of opportunity to have more low fares evidenced by our load factors on certain routes, particularly down at Gatwick. There is a huge upside here if we can get this right and we will get it right.

We are getting it right already, because we have a new fares booking engine on our website already. It is in test mode at the moment and we will ensure that it is robust before we launch it as our prime booking engine. However, I will take you through the process that the customer will see when going onto our website. You can access this by clicking on the front page of our website where there is a little click-through button which says "new ways to book". Indeed, this is a new way to book, because you get what you are after with this way.

London-Amsterdam: you select your airport of departure and where you want to go to, remembering that we have extremely conveniently located airports at both ends of the route. Then you decide the band of time that you are prepared to accept and trade off price. In this example, we have selected 14 days either side of the outbound date and 14 days either side of the return date, so you could go and come back before you even wanted to go!

Having done that, this appears. It is colour-coded, so it is easy on the eye, and we have ringed the £75 fare which will be available on the Thursday. If you wanted to go on

Friday it would cost you £100, you can go on Sunday for £75 but otherwise Thursday is the only option for £75. So that is your outbound journey.

Your return date again: you have decided that Friday is the day that best suits you to come back. In fact there is a fair amount of inventory open at the £75 level on this example. You could come back on Wednesday, Thursday, Friday or Saturday and still pay £75. If you changed your mind and wanted to come back on Tuesday, the return trip price would go up to £90, so the flexibility and choice are yours.

The next level down allows you to choose the time of day you would like to travel and, again, this is colour-coded and you can make trade-offs. If you want to go on the earlier flight, the first flight out, your price would suddenly change to £125. You can say, I don't mind waiting five hours, I will go for £75 still. Again, on the return trip there is only one fare available at £75, this is our inventory management model kicking in because the demand has gone up on this particular day. So £75 is available on that flight only and, if you wanted to change that, you would definitely be paying a higher fare, up to £305 in this example for the next flight which is obviously a busy flight with high demand. So we are doing that already. It is not live yet, it is in test and you can visit it on our website, and we will be introducing that as soon as we are confident that it will be robust and will deliver the volumes that we are planning it to take. This, of course, needs to be packaged with the pricing at the same time and the changes to the distribution we are making. So June is the delivery date for this whole package and this will probably come into the market beforehand.

Moving on to distribution, about four years ago we changed our distribution system in the UK from a 9% commission level down to a 7% commission level. Last April, we decided that we needed to change it again to better reflect the work that the travel agency did on our behalf. If you imagine a long-haul premium journey at 7% of a £5,000 fare relative to a European restricted fare at, say, £90, there is a gross difference between the amount the travel agent receives for a similar amount of work. There is generally more work associated with premium bookings but not that much more. So we reflected that in the price levels for the booking payments that we put in the marketplace in April. What that gave us was a sensible, coherent proposition to travel agents. In percentage terms, the long-haul premium and the non-premium levels came down to between 1%-4% equivalent standard commission from where it would have been.

However, having said that, the European restricted and the European unrestricted and the domestic pieces gave a standard commission equivalent with these booking payments of 5%-10%. Clearly, that is not sustainable and, in particular with the market and how it has changed more recently, we need to adapt. So the changes that we are announcing to the travel trade today effectively move those top two booking payments to £5 and £2.50 respectively; that is a per sector payment. Where did we get that number from? The £2.50 number is based on the cost that we incur in selling a ticket online. So there is a £5 cost, let us say, for a return journey booked through BA.com and that now sets the benchmark, which we believe is a valid benchmark to use given the current market environment in which we are operating. With the flexible fare, there is more work involved and the travel agent can earn more money.

As you can see, it is a reduction of 55%-58%, which is being announced today. In addition, we are announcing another change to our distribution system and that is the way we service our travel agents. Currently, we have a telephone sales centre in Manchester and they ring us to ask for assistance on servicing bookings. It costs us £6 million a year and 95% of the questions they ask are now available either through an online service that we can provide or, indeed, through their own CRS facilities. So the phone number they will be calling from June will cost them, it will be a premium rate number charged at 50p per minute, and we believe that that may encourage them to use the online version or their CRS helplines to resolve some of the issues that they have.

Delivery costs: let me make a few points on specifics within the short-haul business. Fleet simplification and aircraft utilisation Robert has spoken to. Self-service and online processing, whether it be check-in or booking, we believe offers facilities to provide the oil for some of the productivity challenges that we are putting into the business. So there you will deliver unit cost reductions through increased productivity. Simplification on board is not about changing the product that the customer gets; it is about changing the delivery mechanism. A good example of how we can cut cost without changing the product to the customer is in economy, for example, by changing the deli bag that we give out to a box and we can return cater. That supports aircraft utilisation with better turn-round times at the other end of the route, as well as reducing costs on catering, because we are putting more volume through suppliers at one end.

What will the customer see in this new world from June? They will see a new pricing proposition, which gives them more choice, more flexibility and has lower fares which are easily accessible online. The lowest advertised price will be online through britishairways.com as well as through the online third party agencies like ?Travelost and Expedia. Our fares will be easy to access through BA.com as I hope I have illustrated. Choice to use channels is still available, so we are not restricting people from buying tickets through travel agents, which still play an important role in this system.

Our BA direct channels, which are not online, that is to say our telephone sales and BA travel shops, will attract a £10 servicing fee to reflect the cost of undertaking a booking through those channels. All of our fares will be based on e-ticket, which is available on 80% of our network currently. Where it is not available, we will not charge you £10 if you want a paper ticket, that would be silly. However, where it is available and you prefer a paper ticket, we will be charging £10. We believe that e-ticket provides benefits for the customer, benefits for us in terms of processing and, again, we can create better productivity by introducing e-ticket getting to a critical mass, and it also provides cost efficiencies for the travel agent. So we believe that the transformation to e-ticket should be a relatively smooth one.

Finally, we will better package and communicate the way we sell our low fares. I will not divulge how we will do that quite yet but we will make it simple, direct and easy to book. There will be more of it and it will be more regular and with our new pricing structure we will have a more sensible and logical approach for customers to understand how to access British Airways, how to make their own trade-offs and control the choice for themselves as a result of our new inventory management system.

In summary, we are maintaining our strong business offering, it is important for us. We are growing market share in Club Europe and it is very profitable. Our network and schedules will still be driven by the needs of the business traveller. Some of the off-peak flying to which Robert alluded in his presentation will be on leisure routes but not on business routes. So you will not be going anywhere at three o'clock in the morning if you have an important business meeting to get to. Our Frequent Flyer programme remains a core to driving loyalty and high-yielding revenue in our business, and we will compete more effectively with the "no frills" carriers by introducing this new pricing mechanism, having a better proposition online, bringing down unit costs through our distribution savings, better communicated, which in all will lead to improved economy load factors and higher yields on peak flights. I am convinced this will turn us round and make us profitable on short-haul

Europe. With that, ladies and gentlemen, thank you for listening and I will hand you back over to George Stinnes.

Financial Impact & Review

John Rishton
Chief Financial Officer

… slightly. Most of the savings in here are cost savings not revenue driven, but there is a small element of revenue in there as well. The head count reductions, in terms of our front line productivity, we are going to drive up another 1.9 points of margin. Front line, head count reductions, manpower reductions of approximately 8800, about 20% - we are going to drive kind of number. Overhead reductions - the balance of our head count savings – will amount to 4000 plus. Over one third of our overhead is going to be taken out, and that is going to drive a similar amount, another 1.9 points. Finally, procurement and IT - we have already been rolling out a programme on procurement called strategic sourcing, and we are going to make further savings there, and simplification of IT will also help drive cost savings.

Now most of those improvements relate to costs that we control. We are not relying on the premium market quadrupling. We are not relying on revenue bouncing back tomorrow afternoon. These are costs within our control, and we have the ability to deliver this. The improvements that we show here are net improvements. They reflect the fact that we know that some of our costs are going to increase next year, and the best example that I could think of for that is insurance. Our insurance costs next year will be significantly higher than they are this year because we are not going to have the Government helping us for a period of time, and we are going to be paying the full increase in price. So, these are net of known cost increases. They are realistic and they are not wild assumptions.

In terms of our new cost savings that we announced today, these are the key elements. In terms of distribution we will be planning on saving about £100 million, and again Drew took you through a lot of that. A lot of it relates to the UK commission structure with agents. It is our third change in four years but I believe that we now have the balance right between the long haul, the short haul, the cost that we pay to the agents and the benefit we receive. There are other savings in there as well as a result of the switch to on-line.

In terms of procurement and IT, as I mentioned we have had a strategic sourcing programme for procurement, which I believe has been mentioned at these days in the past, and has been in place for a year or so now. One of the key objectives there is that we are reducing our number of suppliers, and we have reduced them so far from 14000 down to 7000 today. We are going to go on to reduce them down further towards a target of about 2000. By reducing the number of suppliers we push more volume through certain key suppliers and we get better prices and better deals.

We also have on on-line trade exchange, Cordiem, which is a joint venture that we are in. From there we will drive savings through auctions (and we have already had some successful experience with that), and further collaborative buying. So we are going to deliver substantial savings in procurement. IT is about simplification, and I will come back to that in a minute.

The last item, manpower, is by far the biggest new element, and that is the £450 million of savings that we are going to drive as a result of taking our head count down by 13000 people.

IT – this is a great slide! You will be delighted to know I am not going to take you through this slide as I could not even if I tried, and that is really the point. This is a small section of our IT architecture as it stands at the moment. It is incredibly complex, and it reflects 40 years of legacy systems. It is a Goddamn nightmare! It is expensive to run, it breaks frequently, and it is a real mess. This is what it is going to look like going forward. Paul Coby, the IT Director, kicked off the new IT 21 programme, as we call it, about six or seven months ago with the sole aim of simplifying our IT infrastructure.

Simplification is a theme here this morning. You have heard about fleet simplification, pricing simplification, and this is another example of where simplification is critical to the business. This will standardise processes. It will reduce errors, which is a key element for us, and it will reduce failure rates and ensure that our systems are robust. We believe that going forward we will reduce our IT operational spend from about three and a quarter percent of turnover to about two and a quarter percent of turnover. So, there will be a significant reduction going forward and this is in line with our major competitors. Historically we have spent far too much on IT operations, and the reason is simply the legacy of systems that we have with the complexity that I showed you on the previous slide.

IT is also a key element in terms of delivering the changes and the items that we have been talking about this morning, and we anticipate that we will spend about £150 million on IT development over the next two years. Most of that spend that we already make on development is substitutional, and we spend about £85 million a year on development each year. Most of it will be substitutional, but not quite all. We are also going to spend more next financial year than the following one. So we are going to front-end load the spend in order that we get the benefits more quickly. The spend will be very, very targeted to deliver specific simplification benefits and the benefits in the areas that we have been talking about earlier this morning.

Turning back to manpower, there will be overhead reductions of over one third. You have said it, the press have said it, and everybody has said it. “BA, you’ve got too many support staff.” We agree and we are going to take out over one third of our head office staff, our support staff, and our management, and we are going to do that as quickly as we possibly can. We are going to take out about 20% of our operational staff, but that will take longer. A prime element of that is driven by productivity changes, and a little bit of volume. It takes longer because it requires negotiation and it requires process change, but most importantly we do not want to damage our offering to the customer over that period of time. So this will be a total of 13000, or a 23% reduction, compared to the August number.

In terms of timing, we will have done 80% of it by the end of next year with the balance falling in the following year. I am personally confident we can do it a little bit faster but this is what we absolutely commit to.

In terms of reductions, as you can see the reductions are across the entire airline. There are substantial reductions in other areas – mainly support areas although support ripples through most of these areas. All of the operational areas have their own support staff and those reductions are buried in those numbers. In some of the areas we are expecting more productivity than from than others. From my finance perspective, I am told that I cannot have less than two pilots at the front of a plane so the flight operations numbers are relatively small compared with some of the other numbers, but there will be a significant reduction from all areas. George also points out to me that it is very important to have co-pilots, particularly on 737s!

So, those are the cost reductions, but let me now turn to an area that I know is of interest to everybody, particularly me, that of liquidity and debt. You have seen this slide before and there is nothing new here, but I want to remind you to set the tone before I talk about debt. We have £1.2 billion of cash at the end of December. We have £600 million of committed facilities. Most of those facilities are secured against aircraft, but some are unsecured facilities. There are investments of about £400 million, which includes our Qantas shares. We also have other assets such as property, aircraft, and inventory of £1.2 billion. This is a total of £3.4 billion available liquidity to us. We are not going to run out of cash despite the third quarter cash burn rate of £1 million before debt repayment or £2 million after debt repayment.

So, let me now turn to debt. A lot has been written about debt, particularly our debt. A lot has been said about it by particularly the newspapers, and I know that it is a matter of concern for most people here to a lesser or greater extent. Everybody seems to be expecting us to do a rights issue. Rod and I said a week last Monday that we have no plans for a rights issue. I would just like to take you through some of the key points related to our debt which underlie the key reasons why we are of the opinion that we do not need to refinance.

The first reason, and maybe the most important, is that we have no financial covenants on our debt – none. The only trigger that we have on our debt relates to the bond issue that we made last year in August of £250 million. This is the only trigger that we have, and unfortunately as far as I am concerned that trigger has already pulled and is completely gone. The trigger there was related to our credit rating, which as you know was down graded, and as a result we will end up paying about an extra £3 million a year in interest. That is all! There are no other triggers in our debt. There are no other financial covenants. Nothing! We do not have any significant repayment spikes going forward – and I will come back to that in a moment.

Key item – the debt is long term and is primarily secured against aircraft, and when we take out the financing we try to match the financing with the length of the service of the aircraft. So typically we will look for 15 – 20 year debt. Our aircraft last 15-20 years. We repay the debt annually going over the lifetime of those aircraft. As it says on the slide nearly 90% is secured and almost all of that is against aircraft. There is very little against property and we have 11% unsecured.

Interest rates – as interest rates fell we were in the fortunate position of having about 75% on floating rate, so we benefited all the way down on 75% of our debt. Most of the balance of the debt was actually at pretty low rates anyway but we benefited as the rates fell on 75%. In the last month or so, as rates have stabilised and we believe that they are pretty close to historical lows, there has not been much opportunity for further reduction. We have fixed 50% of that at just over 5%. The cost of our debt is relatively low. The margin on the floating rate is low. So, unlike some other companies who have a substantial number of triggers, or debt that suddenly has to be repaid in total, we do not have those problems. We do not have any plans for a rights issue.

This next slide shows our debt profile going out to the next seven years. It goes out a lot further than that, but in my opinion it was not necessary to show you that. We have debt going out to 2030. You can see it is relatively flat. We have one small spike in 2005 and we have an unsecured loan of about £200 million to repay. It is flattish! There is no huge debt problem coming our way in terms of repayments. We do not have a year when we suddenly have to repay £6 billion of debt. It is flat.

Some of you were asking about our aircraft, and I believe it was Margaret on the conference call last week who was asking about it in particular. I did not think I answered the question very well so I thought I would have another go this morning. The number of aircraft that we had in the third quarter in service was 367, unencumbered – 44. Of those 22 are secured against a credit facility that we have not drawn down. We have 183 financed, 16 of which will be unencumbered by the end of 2004 - more in the front end than the back end. So we have actually repaid the debt on those aircraft so that they become unencumbered.

We have some extendable operating leases, which are on balance sheet, and we have 98 aircraft on operating leases. Now let me just pick up on that point and talk a little bit more about operating leases because off balance sheet hidden debt seems to be increasingly of interest to everybody.

Our operating lease commitments over the next five years are shown on this next slide. In total our operating lease commitments are £651 million. That is how much we are committed to pay for operating leases assuming that we return the aircraft at the return points. Of the 98 aircraft that we have on operating leases, 63 can go back over the next five years if we choose, or as we get to the end of those leases naturally. As you can see our payments come down over time fairly steadily, and the 63 aircraft are spread fairly evenly over that period, although, as I said before there are slightly more at the front end. This is a total of £651 million of commitments – of operating leases – no more.

So, why do we have so much debt on our books? Well, I am sure you all know the answer to this, and I believe this next graph shows it better than many others that I have seen. We have been buying lots of aircraft in 1998, 1999, 2000, 2001, and to a certain extent in the financial year that will be ending in a few weeks time. Most of these were wide-bodied jets –

777s and 747s but the good news is that we completely finished our wide-bodied replacement. We have no more wide-bodied orders; we have no more huge spend on fleet. The only aircraft that we have on order are these deliveries shown here on this graph and they are all narrow-bodied airbuses. It is fairly clear why our debt is so high, and this gives you an indication of why I am again pretty confident that our debt is going to start going down.

In terms of capital expenditure I will try to lay out what has happened over the last few years. The blue chart bar is our capital expenditure in the last few years, the green one is disposals and how much we have pulled back in as a result of disposing of things, and the red is the net of the two. So, as you can see, in 2001 and this year our capital expenditure of £1.4 billion, £900 million net cash outflow. Next year it is the opposite. As we have already told you our capital spend will be down to about £400 million, as we believe it will be the following year, and this is what we are forecasting. Then in terms of disposals next year these will be approximately £500 million, and about £400 million the year after. So we are making disposals of about £900 million over the next two years.

The disposals are around property, some of which you have been reading about in the press who seem to have good information. For example as well as a New York hotel, the Tokyo apartments that I talked about at Q3, and our Odyssey Business Park we have a whole raft of properties that we are selling. A few of those we will sell and lease back for very short periods of time, but we are basically selling those assets.

There are also some aircraft that Robert referred to this morning - two of our 777s – and we have a guaranteed price from Boeing and they are being returned. Then when we return those two 777s from the cash we receive we will take out the equivalent amount of debt. There is no difference between the two. There are some further assets that we will be selling, and Robert also mentioned some aircraft that we will be selling as well. Over the next two years we will make disposals of £900 million. We believe that net next year we will be having cash coming in, and in 2004 we will be about neutral.

Turning to cash flow, this next chart is not a pretty chart but the green shows our operating cash flow and the red shows how much we have spent in each of those years. Again the red line reflects the capital expenditure that we have been making over the last few years. The pink line at the bottom is the net of the two. So, since 1996 we have been cash flow negative. This year you are forecasting – and I guess I probably would not disagree with you – that we will be cash flow negative again.

Going forward, as we reduce our capital expenditure and make the disposals, but most importantly as we improve our operating cash flow through taking the cost cutting that we have been talking about and as the revenue starts to improve (and I will just say again that we are assuming a modest increase in revenue but nothing significant), we will go cash flow positive quite quickly.

Let me now turn to the Q4 outlook. Results in Q3 were better than expected. Our costs were down more than you expected, our revenue was better than you expected, and our yields was better than you expected. The January traffic stats continued the trend that we have seen over the last four or five months of improving. They are still down and still not good, but they are getting better and we expect that to continue.

Capacity in the quarter will be down approximately 13%. The costs are all heading in the right direction. The unit costs are heading in the right direction. We will take some restructuring costs in the fourth quarter. In total our restructuring costs for the employee reductions are about £200 million. I will take as much as I am allowed to in the fourth quarter, but in total we estimate that the restructuring costs will be about £200 million. Our debt equity ratio, as I have said before, will increase slightly this quarter before going down next year and then falling quite significantly in the following year. It goes up a little bit this quarter as we go through winter but the cash flow is always slower in winter than it is in the summer season.

So, in summary, we have set clear, simple targets which the business understand and buy into. They no longer regard finance as mumbo-jumbo land; they understand it. We are going to have a margin of 10%. We are going to go cash positive, and we are going to reduce the debt. We are going to improve our gearing ratio. We know how to achieve this. We are going to take a series of fast decisive actions covering all areas of the business. We have clear time scales for reductions. I have taken you through the manpower reductions and Robert took you through the fleet changes. We know when we are going to deliver the cost reductions.

We have tightened our internal disciplines. We now have tough centralised control on resources that are much stronger than we have had in the past, particularly on capital and manpower. We are absolutely clear about who makes decisions and where they are made. We will have a leaner and less complex business. This is a key element as we have talked fleet simplification, pricing simplification, and IT simplification. Simplification of processes is required throughout the business. There is lots of opportunity. Taking out our overhead by over one third will force us to simplify our business. It will help us take cost down substantially. The management team is absolutely committed to deliver these. Thanks very much.

George Stinnes: Absolutely, you have heard it! Now, every organiser's worst fear is that the star is missing. The star is clearly finishing up a briefing and he is meant to be here in about three minutes, and by that of course I mean Rod.

[*Housekeeping notice follows with regards to feedback forms being completed*]

Question & Answer Session

Question: One of the key things today is trying to work out how much this is going to cost. The key element of that is labour. I wonder if you could update us, certainly from this morning, as to how the staff are receiving what you are saying, and also what the schedule is from now?

Rod Eddington: I was in here at 7am for an hour and a half with the managers. Concurrent with that, the Head of HR and two or three of our senior Ops people were briefing the unions about what future size and shape was and what it would mean. That was a fairly long session, because we wanted to give them much of the material that you have. I have not been able to speak to those people specifically, so I cannot give you a direct feedback on what the reaction has been.

As you know, we are setting aside £200 million restructuring charge. We recognise that although we have been able to take 6000 odd jobs out of the business since 20 September when we announced the first response to 11 September, we did that pretty much without having to use voluntary redundancy and early retirement; we depended on a range of things including natural attrition. We recognise that getting the rest of the jobs out of the business will require us to use significantly more voluntary severance and early redundancy.

Clearly we want to try and use the other levers as much as we can, and there are some parts of our workforce where the demographics work for us - the pilot community, for instance. The number of pilots and senior captains who reach the retirement age of British Airways over the next two years effectively allows us to solve the issue of pilot redundancies, but there are other parts of the business where clearly we are going to have use voluntary severance to get people out of the business. I think the number we put down for that, £200 million, is the right number. In fact, we are shooting for delivering it less than that. But I think we have made the right provision.

Chris: Two questions, if I may. Ten per cent more aircraft utilisation. Can we flesh that one out a little bit. If you are going to put flights on the shoulders of the day, surely you are not going to attract extra business traffic, therefore you will have to have deeply discounted traffic to fill those planes. How does it make that profitable?

Secondly, on the short haul strategy in general. How do you prevent Premium traffic diluting down once it gets better feasibility of some of these cheaper fares?

Rod Eddington: Increasing utilisation. We have set ourselves a target of 10 per cent improvement in short haul utilisation in the first instance. There are a number of pieces to that. One of the things we have to do is tighten our turnaround times. To give you an example of that. We are looking at our economy class product on short haul. If we can double cater ex-UK, we can take five minutes off our turnaround times without any problems on short haul by double-catering. We have changed the product offering in Economy class, the meal product offering in Economy class on the domestic services, and we will be trialling that on the short haul international services as well.

Moving to a single aircraft type at Gatwick, 737s at Gatwick and ultimately Airbuses at Heathrow, and ultimately Airbus across the fleet, that is longer term as we move away from the 737. In the foreseeable future, it will be 737s at Gatwick. This gives us some efficiencies as well. We have far too much complexity at Gatwick, as Robert would have showed you as part of his presentation. Single aircraft type makes our life much easier.

As to off-peak times, you are right. Moving to off-peak times means that we push into areas where there is less Premium traffic historically. I think that is absolutely right. Not earlier in the day, funnily enough. There was a time when the first flight for British Airways in the morning was 9am, short haul; gentlemen's hours they were called! You can now put on a flight at 6.30am and fill it with businessmen and women going for day turnarounds. I think we can bring stuff forward in the day.

Later in the day, it is interesting. One of the things we will do as we use our management space control systems much better than we currently do is we will recognise that we have more non-Premium customers on that flight, but it is about allowing us to compete with the non-frills carriers. It is an important part of what we do.

So, 10 per cent short haul improvement in utilisation. That is a first shot. We have to do better than that as well.

The second half of your question. All my instincts are that that dilution is a reality today. That business is increasingly shot round on the web, and if people are clear about when they are going to travel and book well in advance, they are looking for the cheapest deals going. We have businesses that use those mechanisms today.

One of the things we have done and will continue to do is to ensure that we use pretty much narrow bodies on the short haul routes. We will continue to put fewer seats into the short haul markets. Dilution is a reality today, and this is not going to change that.

Chris: I have three questions. The first is, Robert mentioned the integration of Cityflyer and European Operations Gatwick. The only thing that that suggests to me is that the cost base of Cityflyer is going up to merge with mainline. Secondly, about the use of franchised operators, obviously there are fewer of those now because you have acquired most of them, but what are your plans for those? Thirdly, the pricing mechanisms and the pricing regime that was being suggested. Is this a new range of prices, or are these prices available now through airnet.co.uk or whatever bucket shop people might use? Is it going to result in you gaining additional revenue by taking these back in house?

Rod Eddington: As you would have gathered from the presentation, one of the real challenges for us is push to simplicity. We have made our business far too complicated at every level. Nowhere is that more apparent than on the pricing front. We are going to radically change the way we price and distribute our short haul product. Those graphs that Drew showed you would have been a clear demonstration of that.

The bottom line is that at periods of the day today, we offer prices that are as cheap as the no-frills carriers. They are a lot smarter about how they go about it. I think what changing our pricing model does is that it means that people will increasingly include us in their search on the web for the right deal to the right destination at the right time of day at the right price. People just don't include us in that set at the moment, although currently the percentage of short haul non-Premium bookings that we take on the web is something like 19%. We are saying that that will go up to 50% in two years time, and that is a legitimate target to shoot for.

I am absolutely clear that this will dial us back into the short haul non-Premium game in a way which perception has dialled us out over the last one or two years. Drew, do you have any more on that?

Andrew Crawley: You have struck the key there. The lowest fare available will be available on-line, and that is different to today. If customers are after the lowest fare, British Airways.com and potentially other third party on-line providers will be the place where they will find that.

Rod Eddington: They have dealt us out of that search at the moment, because finding the lowest fare on the way in which our on-line offering is structured at the moment, you need to have an honest agreement computer. And a lot of time!

You had a couple more questions. Clearly, simplifying our fleet offering includes moving the RJs into the region and moving Gatwick to an all 737 operation. Working with the pilot community in particular to make sure we structure the right deal as we do that will be important. I believe we have a very good chance of achieving that.

Chris: Will there be additional cuts in that area?

Rod Eddington: I don't want to negotiate with the pilots through you, with the best of intentions! Clearly the whole issue of what the cost of doing this is, is the key part of the discussion with the pilot community. We are doing it in part to get fleet simplicity, in part to have the right size aircraft on the right route, but unless we can get our operating costs right, then clearly there is no point in doing it. I am confident we will get it.

The issue of franchises. As you know, I think franchises are a mixed blessing. They take a lot of managing. We have reduced that complexity since I arrived. Some of them folded. Sadly, that includes NGI in Rome. Some of them we have bought, BRAL, and we are consolidating BRAL, BAR and Bryman as we speak. Trying to get a simpler picture there is very important.

Having said that, there are parts of our franchise operation which work extremely well for us right now. GB Airways works well for us. However, we do not see as part of what we are doing today as a wholesale move of services from British Airways into franchisees. Quite the opposite. We are saying that if we can get our unit costs down to where they should be, the financial pressures to do that diminish.

They were the three issues.

Question: In the exhibit, you showed that the relative comparison of fares to the no-frills airline was a Saturday night stay-over. It is obvious to anyone who has looked at these that you are quite competitive, but when you go to fly on Monday to Wednesday as of now, there is quite a big difference. Is that going to change? Or is what you said just relative to weekend stay-over fares.

Rod Eddington: No, we are changing our fare structure across the week.

Andrew Crawley: I can't give specific details about what restrictions we are removing and which ones we are keeping. We will be removing some of them. We are reviewing the whole package of how we price our structure across the market place.

You are right; it did include a Saturday night stay, and currently that is the fence we use to protect or to keep the low yield piece as the low yield piece. That will be reviewed as part of this. I cannot announce today the specific nature of the restrictions we will be removing. We will be leaving some on, and we will be removing some. The total package will become more evident towards June when the whole package comes together, distribution, pricing and online. The reason why it's June is because of the notice period we have to give to the travel agents because we are changing the contract we have with them.

Rod Eddington: The bottom line is that a lot of businessmen and women find a way round the Saturday night stay anyway by buying two back-to-back tickets, tearing out one coupon and throwing it away.

Andrew Crawley: Correct, and there is quite a big upside in terms of load factor in the middle of the week where we can carry these people.

Question: I just have one follow-up question. Do you anticipate, when all this gets put into place, that your yields will be higher, lower or the same as they are at the present time?

Rod Eddington: On the short haul services?

Question: No, total airline.

Rod Eddington: Let's talk about short haul. I think the way we currently price at the moment means that we miss a lot of opportunities. I am actually interested in margin, and what I am absolutely clear about is that the way which we sell price and distribute it at the moment, our distribution costs are far too high. On the short haul, they are far too big a chunk of the total fare, particularly for the lower fare types. We are looking to improve our margin as a result of what we do.

Question: I want to ask more about the 10% operating profit margin target. Just to clarify what was said earlier on about this through the cycle being the target. Does that mean 10% year in/year out, or does it mean 10% is the mid-point of the cycle, and if so, what the high point of the cycle, and what is the low point of the cycle?

Rod Eddington: This is clearly a very cyclical game. We have chosen 10% because that is what the best-of-breed deliver, consistently. The best-of-breed at the moment are delivering zero in the full service game. Clearly that is not true in the non-frills players, but clearly it is true for the full service airlines, the Singapores, the Cathays. The big three in America which were delivering 10%+, and plus by two or three points two years ago, are now firmly in red territory along with us.

We are saying, we will deliver 10% through the cycle, and the cycle in this game, typically, runs at about 5-6 years. It has in the past; whether that's true into the future, I don't know. Clearly we have a considerable amount of work to do to get from where we are to a position where we can deliver that. Bear in mind, that BA has never delivered 10% as I said at the beginning; 9.5% is the best we have done. Equally clearly, we have to take £650 million out of our annual costs, and we have to see a sensible recovery in the broad revenue picture which we don't see happening in the next 12 to 18 months so that we can get up to 10%. But we are talking about through the cycle.

Question: We have had a lot of discussion today about simplifying the business, but if we look at your long haul product with four cabins on each plane. While each little corner of the plane is fabulous, it is a damn complicated operation. Is there any thoughts of simplifying that?

If I may quickly ask a related question? Robert mentioned briefly that the decreasing capacity would have looked larger but for the fact that you are changing the allocation on an aircraft, the proportion of space given over to Premium. Is that a subtle stepping back from where you were?

Rod Eddington: The issue of configs. Let me start with the fourth class. World Traveller Plus is in place on our long haul fleets, and it is doing pretty well for us. Whether or not you would have a four-class offering if you were starting from scratch is a moot point, but the bottom line is that there are many greater complexities that BA has in its business right now than the issue of whether or not we would have four classes on board our long haul aircraft. In a sense, we have currently dusk aircraft and non-dusk aircraft operating out of Heathrow. We have high Js and low Js as you know, 70 in high J and 38 in low J Business seats, Club World seats on board our 747-400s. That is all part of the complexity equation.

As you know we are going to dusk all our aircraft as we must. The issue of how may high J and low J aircraft we have in the fleet was always one area where we did get some ability to balance the Premium/non-Premium mix on board our aircraft generally. Yes, what we have decided to do is to change the mix of high J versus low J aircraft in the 747-400 fleet to basically meet the market needs.

One of the things that is always frustrated about a lot of the things that get said about British Airways – and I am sure we have ourselves to blame for this – is that we managed to create the impression a couple of years ago that we only care about our Premium customers. The bottom line is that we care about anyone who buys a ticket from us, as we must. You cannot say that these customers count and those don't. If you take a low J aircraft, we have 200+ Economy class seats on board a low J 747. We are in the market for large numbers of Economy class passengers.

What will the balance be? At the end of the day, the market decides that, and it is our job to ensure that we have the best products in each of those market segments so people choose to fly with us, but we get the configs right. You and I know the configs are always a compromise. Should we have a high J and a low J sub-fleet in our 747-400 fleet? It is a good question. I believe the answer to that is yes. Why? We have 57 747-400s, and with a fleet of 400s that big, you can afford to have some differences, but we have to substantially reduce complexity.

A lot of the complexity we have in our business at the moment does not come from config. Some of it does. Take our 737 fleet. No two BA 737s look the same, depending on whether they started life in BA, Dan Air, or one of the many leasing companies we have obtained these aircraft from. Having a common Airbus fleet, A319/A320 fleet, common cockpit spec, common engine spec; that's where you get the advantages of complexity out of your business. We are away from being there. We absolutely have to do it.

Anything more on configs? I think we have touched the main stuff.

Question: Just a quick question on the staff reductions. You talk about a total of 13000 staff going out of the business over the two-year period, two and a half years. That is MPEs. I wonder if you can split that down between actual staff leaving, overtime reductions, etc.

Rod Eddington: Did you see the breakdown for the 5,800 we have delivered so far into the business? [*Yes*] You have seen that? So you know it is a combination of all those things. You will know that included in that 5,800 is something like 1500 MPEs that come from people taking part time or leave without pay on a temporary basis. Clearly there is going to be some snap back there. Those people will come back into the business. Not all of them, but some of them.

We recognise that taking jobs out of the business from now on is going to require us, as I said earlier, to use to a great extent voluntary redundancy and early retirement, particularly out of the overhead parts of the business; it is a reality. There are parts of the operational business where we have reasonably high turnover. There are parts were it is effectively zero. Our pilot turnover is effectively zero, but fortunately, as I said a few moments ago, we have a demographic bulge which says a lot of our senior captains are retiring anyway so we can solve that problem relatively easily.

Cabin crew which is where the major numbers are: cabin crew fortunately for us is the part of the business where the turnover is greatest because people find the lifestyle attractive for a while. Some want to stay; some don't. It is also the part of the business, by the way, where the demand for part-time work is greatest.

We recognise we are going to have to use all of these levers to deliver the 13,000. We can. The real question will be, can we do it without having to eat up all the £200 million in restructuring charges that we have put to one side.

In an average year, BA's turnover is of the order of 2000-3000 people.

Question: The 2000 is people actually leaving the business and overtime reductions. It is 1,500 people that may come back.

Rod Eddington: You can have a debate about heads in British Airways, head count. It is a meaningless debate, because how do you count a part-time head, how do you count a temporary head. It is extremely difficult. The thing we are all interested is employee costs, and the best guide to what happens to employee costs is MPEs.

Question: That brings me on to a second question. When we look at these cost reduction targets, £650 million, £450 million, can I go back and look at your 2001 accounts and say in two or three years time, you want to be £650 million lower at the total level, or are we going against some sort of plan which may have happened if you had not made these changes?

Rod Eddington: You will be able to look at the key areas. You will be able to look at our distribution costs. You will be able to look at our spend on people which is a big chunk of this, and you will be absolutely clear about what we have delivered. Total costs? I don't know where fuel costs are going to be in two years time; I don't know where landing and parking charges are going to be; I don't know what interest rates are going to be.

We were talking earlier about the 10% margin. To deliver a 10% margin, clearly we need what I describe as 'still air', i.e. we cannot be flying into the sort of headwind we are at the moment. On the cost issues, we can be absolutely clear about the targets we set ourselves, and the timescales for delivery, and by saying people costs, you can zero straight in on what we have done on MPEs and what we have done on people costs.

You will be able to look at distribution costs, because that is carved out separately in our business, and the targets we have set ourselves there.

Question: It is £100 million less what you spent last year.

Rod Eddington: Correct, absolutely.

Question: Can I just seek clarification on two questions that have been touched on already? First, there was a slide earlier in Robert Boyle's presentation (page 16) that looks at the long haul aircraft at Heathrow and the numbers of sub-types. It talked about Club seats per aircraft type, and it seems to suggest that going forward there will be less Club seats in the long haul aircraft, so does that mean a slight retreat from the Premium strategy? I know it was touched on earlier, but I am just a bit unclear.

Rod Eddington: It is the same answer to the question earlier. We have 70 Club World seats on our high J aircraft, and 38 on board our low J aircraft in the 747-400 fleet. As we play tunes with those numbers in the different types – just to complicate things by the way, after Concorde was grounded, we put 102 Business Class seats on two 747-400s which just operated on the New York route, so we had three configs. This has always been about getting the right balance between the number of Premium seats we offer and the number of non-Premium seats we offer. The market is never the same from one day to the next. Clearly you cannot change your configs every 30 seconds; we don't wish to. We will be real players in the Premium game. That is clear and that is one of our key goals, and we will get the balance between Premium and non-Premium seats right on board our aircraft. Clearly we have to do that.

It is not about a retreat; it is just about constantly having to fine tune this balance. Our Premium market share continues to rise on the key routes where we have dusk aircraft. Unfortunately for us right now, the Premium market overall is well down on many of those routes, as many of our competitors have discovered as well.

Question: The second thing I wanted to clarify on the £650 million of cost savings, how much of that is new today? It strikes me that about half of the £450 million of employee costs were those already announced in September. Are some of the IT costs to do with the Amadeus contract?

Rod Eddington: Let's take the employee costs, because it is the big chunk. We have said 13,000 out from 1 October 2001, of which 5,800 have been delivered already. But, as I said a few moments ago, there is an element of snap-back from some of that 5,800 which will have to be taken out on a permanent basis in the course of next 18 months to two years which we will do. Yes, some of it is out of the business already; some of it is out permanently, some of it is out temporarily. At the end of the day, it needs to be out permanently.

Question: The traditional three questions! First of all on turnaround times. Are you confident that there is enough slack in the timetable with these shorter turnaround times to achieve the reliability which you rightly said is so very key to differentiating your product from the low cost airlines?

Rod Eddington: Yes. We are not trying to approach the utilisation that the no-frill carriers shoot for. You are right; there is a trade-off. There is a trade-off between turnaround times and despatch reliabilities. Turnaround times have never been a big issue for BA. Utilisation has never been a big issue. It is now a big issue. We have to look hard at how we turn aircraft round and what are the things on the critical path. As we change that, we will be able to reduce our turnaround times without impacting on our despatch reliability.

However, we are not saying we are going to match the no-frills carriers on utilisation. Clearly we are not going to do that. Even if you wanted to, you couldn't do it out of Heathrow.

Question: On yield, again. In the past we have had chapter and verse on how the British Airways yield management is one of the best and most efficient in the world. Clearly this is a new form of yield management that is being introduced just today. Are you confident that the net effect will be to improve yields as opposed to reduce them?

Rod Eddington: We have run our yield management systems increasing around and O&D world – Origin and Destination. What we have to do on the short haul is ensure that we run our yield management system around the fare types and pricing transparency we have talked about. Does anyone want to comment on that?

Andrew Crawley: The same people who have been doing good, high quality revenue management today will be doing it with the new system. We have a great deal of experience, a wealth of years in revenue management, and the turnover in revenue management, much like the pilot community, is quite small.

Rod Eddington: In some ways, it is a much simpler model. It is one that works.

Question: A final question, please. Just to clarify, you said at the very start your revenue assumptions in terms of growth are modest. Can you clarify what you meant by that in terms of individual passenger yields or in terms of total turnover?

Rod Eddington: We are not going to be talking about that. We have made very modest assumptions about what our revenue growth is going to be, but we are not going to be talking publicly to our competitors about what assumptions we are making on revenue.

Question: Can I just ask one clarifying question on the capacity reductions at Gatwick? You said 52% down. Will that result in slot abolitions? What kind of slot abolitions will we see?

Rod Eddington: I will get Robert to talk on slots in a moment, but remember a lot of that capacity reduction comes from moving long haul aircraft from Gatwick to Heathrow, and in doing that we take a lot of ASKs out of the Gatwick catchment area. Robert, do you want to talk about slots?

Robert Boyle: Clearly, the reductions we have already made this winter have resulted in slots being freed at Gatwick which a number of our competitors have been quick to move in on, in particular Easyjet. It is not only ourselves that have cancelled Gatwick services. A number of other traditional carriers have done so. Slot availability at Gatwick is significantly higher than it ever has been, and from our point of view, Easyjet will be able to secure the kind of growth rates that they have been talking about, or at least in the range they have been talking about. If that is what lies behind the question, it is safe to assume – and we have certainly assumed in the work we have done here – that we will face a significant low cost presence at Gatwick, and we need a model which is capable of dealing with that.

In terms of the figures here, something like a 30% reduction in the total departures from Gatwick lie behind these figures. Where that comes out – whether that is lower towards the 20% range in terms of the BA group will depend to some extent on decisions which are made in dialogue with some of our partners such as GB Airways as to whether any of those slots are of interest to them.

Rod Eddington: That would leave us with about 40% of the schedule capacity at Gatwick?

Robert Boyle: That sounds about right. I haven’t counted them.

Rod Eddington: That feels about right, so we are still far and away the largest scheduled carrier at Gatwick.

Question: The second question I have is when you reduce network complexity and you streamline the business, what role does Deutsche BA have at the moment in this scenario?

Rod Eddington: There are key parts of British Airways as it is today which are going through their own future size and shape exercise, and Deutsche BA is doing that right now. The interesting thing about Deutsche BA is that Air Liberté we disposed of shortly after I arrived (in a nanosecond – I think!). Air Liberté was burning a huge hole in our pockets. Deutsche BA is not. It is a well run business, operationally. It is a tough market because it is up against a big dominant player in Lufthansa, very good airline, but Deutsche BA is a much more efficient, much better airline than Air Liberté. They are going through their own future size and shape exercise right now.

I have been through their first preliminary conclusions with them, and will have another session with them shortly.

Question: On the pricing structure, obviously you want to feature on the radar screen of the low fares purchaser. How will you keep the low fares purchaser there if your unit costs are not going to equal an Easyjet, for example. How will you manage to keep the pricing structure sufficient low?

Rod Eddington: We are not saying that we will usually be the lowest fare in the market. That is not the game we are in. We are not going to become a low cost carrier. We couldn't become a low cost carrier even if we wanted to. However, we will have a value-for-money proposition that is much more approachable than the one we have at the moment. We are not going to be able to common price with the no-frills carriers for the simple reason that our cost base will not be the same. We will be able to close the gap by doing some of the things we have talked about today, but by ensuring that we operate from airports like Heathrow and Gatwick and by ensuring that we have a better product offering, and appropriately better product offering, we will be able to have a value-for-money proposition in front of the customer that we think has a good chance of getting that customer. But if that customer is shopping on price, price and only price all the time, there are many times when we will not get the business.

There are some times when we will depending upon when we have seats available and where. It is about closing that gap. It is about knowing that gap, not closing it in its entirety.

Question: I have two questions. What is the way forward in terms of your alliance structure, given that you have failed to gain anti-trust immunity? Secondly, how do you ensure that travel agents do not direct bookings to the biggest payers in terms of commission?

Rod Eddington: Remember, the change to commission structure applies to non-Premium, short haul passengers who are pursuing these cheaper fare types. It does not apply to other customers in the mix. That is an important point, very important for the travel agents.

As to alliance, as you know, we were keen to get an immunised relationship with American, but we said right at the beginning that this was only a deal we would do if the regulatory price was right. It was not, not by a long way. We asked the regulators on both sides of the North Atlantic, I asked them personally. Right at the beginning of this, I said "BA and AA were minded to apply for anti-trust immunity. We believe the world has changed since we tried in 1996. You have United, Lufthansa and Star who have ATI. The French and Delta will soon have it. You have British Midland and Star, so we think the regulatory price is much lower. If you disagree with us, tell us now and we will save your time and ours".

We were told the world had changed and the regulatory price would reflect that. That proved not to be right. As soon as we were clear about what the regulatory price was, we walked. That means we will not have an immunised relationship with American on the North Atlantic. That is a disappointment to us.

Our focus was always going to be after we had done that to work more closely with our European partners in **one**world, and that is now a priority. Iberia, particularly, is a critical part of what we do in **one**world. We are also in talks with Cathay about what we can do with them. The value from being in **one**world comes from the bi-lateral relationships that exist inside **one**world rather than being in **one**world *per se*.

The observation I always make to our people is that the benefits of an alliance is the cream on the cake, and the cake is the core business. We have to build a stronger core business and that is what today is about. There is no mention of alliances today, not because they are not important to us; they are. We are focusing today on our core business.

Question: A couple of questions on Gatwick, please. First, on long haul. Robert mentioned how some routes can be profitable at Gatwick that cannot be profitable at Heathrow, bearing in mind that we have always heard about the strength of the yield in connecting traffic at Heathrow. Perhaps you could put a bit more detail on that, please. Secondly, with regards to short haul, you are still going to have quite a substantial short haul business down at Gatwick. Can you tell us what kind of routes can be competitive with the low cost business model at Gatwick in the longer term?

Rod Eddington: Why don't I take the second of that which is the issue of short haul being competitive at Gatwick, and leave Robert to handle the question of the long haul services which we are going to continue to operate from there?

One of the problems we have had at Gatwick is that because we have had such a large long haul business, a lot of the short haul offerings have been built around connecting the long haul, so we have been running short haul services out of Gatwick which are sub-optimum for the O&D market in the Gatwick catchment area. It is a real market. There is a reasonably sized Premium market out of Gatwick, and by restructuring our short haul business around O&D out of Gatwick rather than connecting to the long haul, we are doing a better job of capturing that Premium business.

We are going to continue to do that. I am confident that we have a short haul model that is viable at Gatwick, but we have to de-link it from the long haul business to take advantage of it. It has been a real problem for us.

Robert Boyle: I will just clarify what I said. I did not particularly say there were long haul services which could be profitable at Gatwick which could not be profitable at Heathrow. It was more that there were services which we could not fit into Heathrow, and did not particularly benefit from moving there. A good example is the Caribbean network. We have no strong Heathrow-based competition. It is primarily leisure business, and it is primarily UK originating local traffic, so that type of operation works very well out of Gatwick. We cannot really find, and would not necessarily want to find the slots and other space at Heathrow to fit it in, and that rump of long haul business we think can work well and is an important part of our network.

Question: Just one question. You are letting go 1500 engineers. Could you address the safety issue associated thereto?

Rod Eddington: This is a difficult debate to have in the public domain in part because people assume that if you are letting engineers go, you must be reducing the amount of maintenance you are doing. We would never do that. I tell you, I was on the Board of HAECO for five years, and I have been in the industry for 20 years. I cannot understand British Airways maintenance procedures.

Boeing produced aircraft. They are maintained on an A Check, B Check, C Check, D Check cycle by just about everybody in the world but British Airways. We have re-invented the maintenance schedule for these aircraft. 'Industry standard' is not an expression that resonates around the corridors here. I understand where it comes from because there was a time when British Airways was the sole operator, or the major operator of a particular aircraft type, the Viscounts of this world, when British Airways effectively took from the manufacturers the maintenance requirements and built the maintenance schedules for themselves.

We have continued to do that, even though Boeing have perfectly good maintenance schedules for 747s, and 777s and Airbus have the same. We must change the way in which we maintain our aircraft. We have significant numbers of engineers whose job it is to constantly fine tune British Airways stand-alone maintenance procedures. It has to change. The aircraft in my view are no safer because we do it that way. No-one says 'I'm not going to get on a Cathay Pacific or a Singapore Airlines 747-400 because they maintain them to industry standards.

Question: I have two questions if I may. First, you have indicated that the phase-in of your cost reduction programme is £450 million at the end of March 2003 and then £650 million at the end of March 2004. Since such a large component of this is personnel costs, how can you give us additional confidence that presumably two-thirds of that reduction could be seen in the first year?

Rod Eddington: Because we have taken £580 million out in three months.

Question: Some may say you have taken the easiest bit out.

Rod Eddington: We have taken the cheapest bit out. You can always take people out of any business if you put attractive enough voluntary redundancy programmes on the table. Throwing money at departing people from the business is the easy way out. Actually, we have not taken the easiest bits out because we have taken 5,500 to 6000 people out with virtually no voluntary redundancy payments on board. That is the toughest way to do it.

The easiest way to do it is to throw money at it, and so we have set aside £200 million for the second half of this exercise because we know we are only going to get significant numbers out of the business in the next 18 months if we are prepared to make voluntary redundancy payments to people to go.

British Airways has taken significant numbers of people out of its business in the past, and it has done it primarily by paying them to leave. The voluntary redundancy programme we announced after 20 September is a less generous one than the one that British Airways has historically used, but we believe, nevertheless, that it is generous enough to get us where we want to go.

Question: Thank you. The second question relates to the timing of your disposals. You said £900 million total. We know that two aircraft are in the process of being sold back to Boeing. Can you give us any further detail on the timing versus year end, between year end 03 and year end 04 of that £900 million? In the future, is it your intention to lease … [*gap in tape, no overlap*] … your aircraft under operating leases or to actually purchase them?

Rod Eddington: I will answer the second part of that, and leave John to answer the first. In the main, the cheapest lift is the lift you own rather than the lift you lease. It is good to have a percentage of your capacity leased on operating leases, and British Airways has a reasonable percentage of its short haul lift pretty much on operating leases to give us a bit of flexibility. Historically, the big leasing companies have not been much interested in wide body lift, and so it has been much harder to get large, wide-bodied aircraft on operating lease. That is changing a little, and clearly if we had some aircraft on operating leases at the moment on the wide body front, coming due right now, we would be returning them. We don’t.

I have to say nothing comes for free. You pay for that flexibility, and you do it through lease payments. It is always a balance. I do not see any fundamental shift in the way in which British Airways acquires lift in the years ahead.

John, do you want to talk to the capital issue?

John Rishton: A couple of things. In terms of the capital expenditure we showed you for the next two years, that assumes that we buy the aircraft, we don't operate on lease any of those aircraft, so we assume that we buy them, and that is a capital expenditure spend.

In terms of the £900 million of disposals over the two years, I highlighted two 777s that we know we are going to get rid of and we know how much we are going to get for those. I highlighted some property disposals which are almost done. There are a number of other items that are almost done which I will not go into now, but we will clear up with you later as they become more public. We are confident that we can make £500 million of disposals in the next financial year, and about £400 million in the following year. I don't want to go into any more detail in any of those here and now.

Question: You talked about an increase in leverage over Q4 and also Q1 next year. There is also a £600 million or so bank debt repayment in 2003. Are you confident that the property disposals and the cash on balance sheet will be able to meet that financing requirement plus any other operational cashflow items which you may be seeing with regard to restructuring in 2003?

Rod Eddington: Yes! [*Pause*] John is not going to let me get away with just that!

John Rishton: I was just going to say yes, absolutely. I want to make clear that what I said was that our gearing ratio would go up slightly in the fourth quarter and then come down through the next year slightly. I didn't say what it was going to do in Q1, but it will come down next year.

Question: I was wondering if you could give us some figures for the total change in available seat kilometres for March 03 and 04, and also if you could talk a bit about how big an opportunity you have to raise the load factor by the pricing initiatives you are taking?

Rod Eddington: Sorry, what was the question? The difference between ASK 2003 and 2004? What was the question?

Question: What is the change in ASKs in the year you are about to start and the year after that?

John Rishton: The ASK changes on a financial year basis rather than a airline season basis. Is that the question?

Question: Yes.

John Rishton: I do not have a figure I am going to quote here today. It is actually fairly straightforward to get it. We have given you figures in the pack on what the summer 02 capacity figures are relative to summer 01. Winter 02, which is the second five months of the financial year will be virtually a standstill on capacity versus the current winter season, so our capacity reductions are basically finished in headline terms next summer, so you have seven months of the reductions we have shown you here, and then a flat year on year for the winter, and basically it is then a flat picture thereafter.

Rod Eddington: The issue of load factor. Clearly, one of the opportunities for British Airways is our short haul load factor. Because of the way in which we price and distribute and because of the way in which we have built our rev man systems, our short haul load factor is much lower, so there are some real opportunities on the short haul side to get higher load factors.

Question: Two issues. You have talked about simplicity and communication. I am not quite sure what British Airways stands for, because I am not really sure whether the short haul value-for-money proposition sits with the long haul, in certain respects, Premium brand-type proposition. I wonder if you can square those two and talk about how you are going to communicate the different messages to different parts of the market?

Rod Eddington: Let me answer that one first. We are a full service network airline that operates a Premium and non-Premium product. We are in both markets, like every other full service airline, Singapore Airlines, Cathay Pacific. There is that issue that was quite rightly raised earlier about whether a fourth class on board our long haul aircraft is a bridge too far in terms of complexity. It is a moot point, but we are in the same game that everybody else is. We are after Premium customers, we are after non-Premium customers, short haul and long haul, and they all matter.

Question: Thanks. The second question is much more a market specific question. I wonder if you could share with us what rate of change – I guess downwards – you think the Business Class market, short haul, has been doing structurally, and obviously cyclically it has been very weak in the last year or so, but I mean more on a medium term view.

Rod Eddington: It is a good question; it is a difficult one to read. Our short haul Premium customers are 'time poor' so they pay for convenience and access. They are prepared to pay good money for seats that are available at short notice, and many of them prefer to use Heathrow, and quite a few of them Gatwick as their point of departure in the UK; clearly our two strengths. There are also Premium customers who want the additional product features that we offer.

Where is that market going? None of us really know. Clearly the non-frills players are really dynamic now, and they are changing some of that. I have no doubt there will be a significant short haul Premium business. We just have to make sure we capture it intelligently. Part of what future size and shape is about is how we can participate much more aggressively in the non-Premium short haul business. To talk about distribution, on-line, about a simpler product, about higher utilisation is all about that market, but there is a big piece of work that has also been done on ensuring that we remain a major player in the Premium short haul market.

Now, you and I know that those blur, that even for the no-frills carriers on some routes they enjoy extremely good yields. You only need to look at the fare availability on their websites on some of their short haul routes to recognise that. Whatever happens to that market, we have to make sure we have the right offering at the right price. I wish I could be more definitive and say it is going to be 10% bigger or 10% smaller in two or three years time. I cannot do that. We will have to live with whatever the outcome is.

The interesting thing for me about the Premium market is that on the long haul, some carriers have chosen to get out of parts of the Premium market and that has meant that those who have chosen to stay in have done significantly better than they would have otherwise. We asked ourselves the question about our First Class product, and whether or not we should stay in the First Class game. That is a question that most airline people ask themselves from time to time. The fact that many players have got out of the First Class game has meant that we have done rather better than we would otherwise.

I would like to be more specific, but I cannot be on the Premium short haul. Andrew, you live in the market place day in and day out. How would you answer the question, what do you think is going to happen to the Premium short haul?

Andrew Crawley: I would answer exactly in the way you have done!

Rod Eddington: That is a very good answer! You mean, you don't know either!

Right. Lunch. Thank you very much. [*Applause*]